

Message Text

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PAGE 01 STATE 146779
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PARIS FOR OECD

E.O. 11652:GDS

TAGS: EFIN, ECON, PO

SUBJECT: VISIT OF PORTUGUESE FINANCE MINISTER

1. SUMMARY: PORTUGUESE FINANCE MINISTER VITOR CONSTANCIO, ACCOMPANIED BY CENTRAL BANK GOVERNOR SILVA LOPES, CALLED ON UNDER SECRETARY COOPER JUNE 7, TO REVIEW PORTUGAL'S ECONOMIC PROSPECTS AND EXTERNAL FINANCIAL NEEDS. CONSTANCIO PROJECTED MAJOR (\$1BILLION PER YEAR) BALANCE OF PAYMENTS SHORTFALLS OVER THE NEXT 5 YEARS WHICH WILL RESULT MAINLY FROM INTEREST PAYMENTS ON FOREIGN DEBT AND FROM STRUCTURAL PROBLEMS IN AGRICULTURE AND THE EXPORT
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PAGE 02 STATE 146779

SECTOR. HE PROPOSED THE CREATION OF AN OECD-LED ASSISTANCE PROGRAM FOR PORTUGAL. MR. COOPER CONGRATULATED CONSTANCIO FOR ADOPTING THE TOUGH IMF PROGRAM, AND SAID THAT WHILE WE ARE SYMPATHETIC TO PORTUGAL'S NEEDS, IT IS TOO SOON TO TALK ABOUT ADDITIONAL US ASSISTANCE. HE SAID THAT WE WILL BE CLOSELY FOLLOWING THE SITUATION IN PORTUGAL AND WILL CONSIDER THE SUGGESTION FOR AN OECD

APPROACH TO ALLIED ASSISTANCE. END SUMMARY.

2. CONSTANCIO AND SILVA LOPES SPENT AN HOUR WITH UNDER SECRETARY COOPER JUNE 7 AND OUTLINED THE NATURE OF ECONOMIC PROBLEMS AHEAD FOR PORTUGAL. CONSTANCIO SAID THAT ALTHOUGH THE INFLATION RATE MODERATED IN THE FIRST FOUR MONTHS OF 1978 (TO AN ANNUAL RATE OF 21 PERCENT), AND THE BALANCE OF PAYMENTS SHOWS SOME IMPROVEMENT, CREDIT POLICY INITIATED AT THE BEHEST OF THE IMF WILL POSSIBLY RESULT IN NUMEROUS BANKRUPTCIES AND HAVE A SEVERE SOCIAL AND POLITICAL IMPACT. CONSTANCIO STATED THAT THE ECONOMIC PROJECTIONS OVER THE NEXT FIVE YEARS ARE WORRISOME. ASSUMING A TWO PERCENT GDP GROWTH RATE TO 1980, FOUR PERCENT IN 1980-82, SIX PERCENT IN 1982-84, AND AN 8 PERCENT AVERAGE INCREASE IN EXPORTS OVER THE 1978-84 PERIOD, PORTUGAL'S CURRENT ACCOUNT DEFICIT WILL BE DOLS 1 BILLION A YEAR FROM 1978 THROUGH 1982. THE PERSISTENT DEFICIT WILL BE DUE PRIMARILY TO INCREASING INTEREST PAYMENTS ON FOREIGN DEBT (RISING FROM DOLS 300 MILLION IN 1977 TO DOLS 630 MILLION IN 1980). UNEMPLOYMENT WILL BE AGGRAVATED, SINCE CONTINUED EMIGRATION TO EC COUNTRIES IS NOT POSSIBLE AND THE ASSUMED GDP GROWTH RATES (WHICH MAY BE TOO OPTIMISTIC IF EUROPE'S ECONOMY DOES NOT PICK UP) WILL NOT CREATE ENOUGH JOBS TO ABSORB THE NATURAL GROWTH OF PORTUGAL'S LABOR FORCE. CONSTANCIO QUOTED A RECENT OECD STUDY, WHICH STATED THAT THE CURRENT ACCOUNT LIMITED OFFICIAL USE

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PAGE 03 STATE 146779

DEFICIT IN 1985 WILL BE EQUAL TO 15 PERCENT OF PORTUGAL'S GDP.

3. CONSTANCIO SAID THAT AUSTERITY ALONE WILL NOT END PORTUGAL'S RECURRING DEFICITS. DRASTIC STRUCTURAL CHANGES ARE NEEDED IN THE ECONOMY. HE TALKED ABOUT PLANS TO MAKE PORTUGAL SELF-SUFFICIENT IN AGRICULTURE WITHIN 5 - 10 YEARS AND OF THE NEED TO RESTRUCTURE THE EXPORT SECTOR AWAY FROM PRODUCTS IN SURPLUS IN THE EC, AND TOWARD MACHINE TOOLS, ELECTRICAL APPLIANCES, CEREALS AND OIL SEEDS. CONSTANCIO REMARKED THAT PORTUGAL WOULD NEED CONSIDERABLE OUTSIDE HELP IN RESTRUCTURING ITS AGRICULTURE AND EXPORT MANUFACTURING SECTORS IF IT IS TO AVOID THE SERIOUS POLITICAL CONSEQUENCES OF PROLONGED AND GROWING SOCIAL AND ECONOMIC SACRIFICE-- AN INCREASE IN PUBLIC SUPPORT FOR THE EXTREME RIGHT. (HE EMPHASIZED, HOWEVER, THAT THERE IS NOT NOW ANY SERIOUS THREAT FROM THE POLITICAL EXTREMES.) HE SAID THAT PORTUGAL'S CENTRAL BANK CAN INCREASE ITS RESERVES THROUGH FOREIGN COMMERCIAL BANK LOANS, AND THE EC IS PREPARED TO INCREASE ITS SUPPORT TO PORTUGAL. NEVERTHELESS, OVER THE NEXT YEAR PORTUGAL "WILL NEED ATTENTION FROM

THE US" AND SUPPORT FOR A NEW WESTERN ASSISTANCE EFFORT. CONSTANCIO SUGGESTED THE "WE" (IMPLICITLY THE WESTERN COUNTRIES) FORMALLY DISCUSS THE MATTER BEFORE THE END OF THIS YEAR IN AN OECD FORUM. (AFTER THE MEETING HE REMARKED THE OECD WOULD BE MORE ACCEPTABLE TO THE EUROPEANS THAN ANOTHER US-LED LENDING EFFORT.)

4. THE UNDER SECRETARY CONGRATULATED CONSTANCIO ON THE JUST-CONCLUDED IMF AGREEMENT AND SAID THAT WE ARE IMPRESSED WITH THE STABILIZATION MEASURES THAT HAVE BEEN TAKEN. HE ADDED THAT WE CONTINUE TO HAVE GREAT INTEREST IN WHAT IS HAPPENING IN PORTUGAL AND THAT WE WILL CONSIDER THE SUGGESTIONS OF CONSTANCIO, INCLUDING THE NEED TO REVIEW PORTUGAL'S LONG-TERM FINANCIAL SITUATION LATER LIMITED OFFICIAL USE

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PAGE 04 STATE 146779

THIS YEAR (PERHAPS IN THE FALL) AND THE POSSIBILITY OF AN OECD ARRANGEMENT FOR PORTUGAL. THE UNDER SECRETARY SAID THAT IT IS TOO EARLY, HOWEVER, TO TALK ABOUT FURTHER US ASSISTANCE FOR PORTUGAL. HE ALSO SUGGESTED THAT THE PORTUGUESE MIGHT GIVE MORE CONSIDERATION TO THE POSSIBILITIES FOR INCREASED TOURIST RECEIPTS AND THE PROSPECTS FOR GREATER FOREIGN INVESTMENT BY COUNTRIES WITH SURPLUSES, PARTICULARLY THE FRG, SHOULD THE EC ECONOMIES SHOW MORE VIGOR IN THE 1980'S.

5. SILVA LOPES THEN DISCUSSED THE EFFECTS OF THE STRICT CREDIT POLICY ON PORTUGAL. HE SAID THAT INCREASED DOMESTIC INTEREST RATES WILL ABSORB MUCH OF THE IMF-APPROVED CREDIT CEILING, RESULTING IN A REAL DECLINE IN TOTAL CREDIT AVAILABLE AND AN INCREASE IN INDEBTEDNESS BY ENTERPRISES. CONSTANCIO MENTIONED THE NEGOTIATIONS CONCERNING PORTUGAL'S EC APPLICATION WOULD BEGIN BY THE END OF 1978 AND THAT IT WOULD PROBABLY BE 14 YEARS BEFORE FULL AND UNQUALIFIED MEMBERSHIP IS COMPLETED. VANCE

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